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RUEHVB/AMEMBASSY ZAGREB PRIORITY 1221
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C O N F I D E N T I A L SECTION 01 OF 02 BUDAPEST 000030

SIPDIS

STATE FOR S/CEE FOR AMB MORNINGSTAR AND REBECCA NEFF,
EEB/ESC FOR DOUG HENGEL AND ALEX GREENSTEIN, EUR/CE FOR
JMOORE, EUR/ERA FOR SJOHNSON, AND EUR/RUS. COMMERCE FOR
HILLEARY SMITH. ENERGY FOR MAPICELLI AND MCOHEN. PLEASE
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E.O. 12958: DECL: 01/21/2020

TAGS: [ENRG](#) [ECON](#) [EPET](#) [PGOV](#) [RU](#) [HU](#)

SUBJECT: GOH SOON TO ENTER SOUTH STREAM JOINT VENTURE WITH
GAZPROM

REF: A. 2009 BUDAPEST 195

[1](#)B. BUDAPEST 26

[1](#)C. 2009 BUDAPEST 843

Classified By: Econ Officer Jeffrey M. Jordan, reasons 1.4 (b),(d)

[1](#)1. (C) Summary: Hungarian officials will soon sign a set of agreements to establish a Russian-Hungarian joint venture to commence work on the feasibility study for the Hungarian segment of the South Stream pipeline project. This will set the project in motion after nearly a year of apparent stagnation, which included an apparent Russian overture to Croatia as a potential partner, instead of Hungary. The Hungarian government and main opposition party support the project as a means to bolster Hungary's energy security by diversifying the routes by which it receives gas imports. End Summary.

RUSSO-HUNGARIAN JV TO PURSUE SOUTH STREAM

[1](#)2. (SBU) The GoH has announced that it will soon sign agreements with Russian energy giant Gazprom to establish a jointly-owned (50-50) project company, South Stream Hungary Zrt. (SSH), to undertake the Hungarian stretch of the South Stream pipeline. The state-owned Hungarian Development Bank (Hungarian abbreviation MFB) will represent the GoH in the joint venture and MFB Chairman Janos Eros will serve as the Chairman of SSH for one year. Gazprom Deputy Chairman Aleksander Medvedev will serve as Deputy Chairman of SSH. After an initial capital contribution of 5 million HUF (roughly \$27,000), Gazprom and the MFB will increase the company's capital to 50 million HUF (\$270,000).

[1](#)3. (SBU) SSH's primary function at this point will be to commission a feasibility study for the Hungarian stretch of the pipeline, eventually leading to a 2011 decision point on whether the Hungarian segment should be built. According to the March 2009 Basic Cooperation Agreement between Gazprom and the MFB (ref A), SEPCo, a joint-venture between Gazprom and Hungarian energy giant MOL, will complete the study. Upon completion, SSH would also retain 100 percent ownership of the Hungarian segment of the South Stream pipeline.

14. (SBU) MFB Chairman Eros explained to Econoff on January 15 that MFB's primary role is to represent the Hungarian government's interest in South Stream. He admitted that it probably would have been "more logical" for MOL to represent Hungary in the joint venture, given that it had already been tipped to do the feasibility study, but he posited that the GoH may have designated the MFB as the partner based on its probable role as a financier of the roughly \$1.5 billion Hungarian segment. If/when the pipeline is completed and ready for operation, Eros said, the government in power may decide to replace MFB with an energy company in the joint venture.

PM BAJNAI CALLS A BRIEF TIME-OUT

15. (C) Prime Minister Bajnai has indicated to us that he intends to pursue the project more cautiously and transparently than his predecessor did. On June 12, the day that the Hungarian press initially reported that the signing would occur, the Prime Minister's Office placed a "heads-up" phone call to the DCM to outline the general parameters of the agreement. Later in the day, however, Prime Minister Bajnai opted to postpone signing the documents until a Hungarian-Russian intergovernmental meeting scheduled for late January, at which Hungary will be represented by Finance Minister Peter Oszko. (Note: Janos Eros expects this to take place on January 28 or 29. End Note.)

16. (C) In his January 14 introductory meeting with Ambassador Kounalakis (ref B), Bajnai explained that he wished to study the agreement further to better understand "the whole Russian

BUDAPEST 00000030 002 OF 002

position," without further elaborating any specific concerns about the draft agreements as such.

17. (C) The Bajnai government, nonetheless, places importance on South Stream as part of its energy security strategy (diversification of supply routes). Under last year's Basic Cooperation Agreement, Gazprom and the MFB agreed to establish SSH and complete the feasibility study during 2009. MFB Chairman Eros told Econoff that "Gazprom is about 85 percent responsible" for the delays in establishing SSH.

18. (C) Of greater concern to the GoH, but probably related to these delays, are Gazprom's efforts to strengthen its position in the West Balkans and the possibility that South Stream could follow a route that excludes Hungary (ref C). Bajnai briefed the Ambassador on recent Russian moves to gain influence in the Croatian energy sector and then on January 18 traveled to Zagreb to meet with Croatian Prime Minister Kosor to discuss, among other things, energy security. (Note: Following their meeting, Bajnai and Kosor announced that the 6.5 bcm gas interconnection between the two countries would be completed by the end of 2010, providing an eventual link to the proposed Krk Island re-gasification terminal. End note.)

RUSHING TO SEAL THE DEAL BEFORE ELECTIONS, DESPITE POLITICAL CONSENSUS

19. (C) Despite its earlier rhetoric to the contrary, main opposition party Fidesz seems to agree with this approach, or perhaps it no longer finds South Stream a useful front on which to attack the current government. Fidesz leader and probable future Prime Minister Viktor Orban has admitted to us that he would pursue a similar policy on South Stream (ref C), and Fidesz' studious silence on this latest announcement stands in stark contrast to its combative responses to previous such agreements.

110. (C) Notwithstanding the likelihood of policy continuity on South Stream after Hungarian parliamentary elections in April, both sides are reportedly in a hurry to do a deal before then. Daniel Kaderjak, staff assistant to Parliamentary Nabucco Chairman Janos Koka told econoff of

rumors around Parliament that the Hungarians were the ones pushing hardest to reinvigorate the South Stream Hungary project. Janos Eros, however, said that the Russians, despite nascent talks with Fidesz leader Orban on the issue, were in a hurry to sign the deal before the election.

¶11. (C) Comment: Bajnai's desire to ensure the security of his country's future gas supply through alternative routes such as South Stream is understandable. Hungary depends on natural gas for about 40 percent of its primary energy supply, 80 percent of which comes from Russia. While energetically supporting the Nabucco pipeline project, Hungary has always been concerned that South Stream would move forward without it. Even considering the long-shot that the pipeline will ever be built, it makes sense to retain good working relations with the country's most important energy supplier. End Comment.

KOUNALAKIS